

Statement of the Michigan Housing Council  
Regarding  
HOUSE BILL NO. 6167

My name is Dennis Varian. I am the chairman and past president of the Michigan Housing Council. The Michigan Housing Council is the industry association for the affordable housing industry in Michigan. The Council has 176 members representing owners, developers, architects, engineers and property management companies involved in producing and maintaining affordable housing in our state. Council members own and operate approximately 40,000 affordable rental units in the State of Michigan. The Housing Council and its members work closely with the Michigan State Housing Development Authority to assure a continuing supply of well maintained affordable housing in Michigan.

In 2003 an amendment to the Income tax act of 1967 was passed by the Legislature. The amendment required, among other things, that every flow-through entity such as partnerships, withhold a tax for each nonresident member based on the nonresident member's share of the taxable income of the entity.

Most affordable housing developments in Michigan are owned by flow-through entities, typically limited partnerships. Many such entities have nonresident partners who have made investments in the developments or partners who have become nonresidents since making such investments.

This amendment created a conflict with federal regulations governing Department of Housing and Urban Development (HUD) subsidized affordable housing developments and set forth in Regulatory Agreements for each such property. HUD regulations, as set forth in the Regulatory Agreements limits cash distributions to owners and the participants in ownership to no more than twice per year and only from "Surplus Cash and Residual Receipts" as determined by a Certified Annual Audit, reviewed and approved by HUD. "Surplus Cash" is that cash produced by rental income and not required for the ongoing operations of the property. "Residual Receipts consist of surplus funds from previous years not distributed to the owners".

The HUD Regulatory Agreement also sets a maximum amount for annual cash distributions.

Affordable housing with assistance from the US Department of Agriculture has similar limits on cash distributions.

The State Housing Development Authority Act of 1966 provides for similar limits to cash distributions to owners. Developments with mortgage financing from the Michigan State Housing Authority (MSHDA) also have recorded Regulatory Agreements which establish, among other things, maximum cash distributions. These Regulatory Agreements limit such cash distributions to be made only from "Surplus Cash" as defined by the Regulatory Agreements and determined by an annual certified audit, approved by MSHDA. The Regulatory Agreements require MSHDA's prior written approval prior to making cash distributions.

A payment of withheld taxes by the flow-through entity on behalf of a nonresident member would be considered a cash distribution since it goes to the benefit of the partner in paying his or her tax obligation or will be refunded to the partner if it is in excess of their obligation.

Unfortunately, some affordable housing developments regulated by HUD or MSHDA, may not have sufficient "Residual Receipts" or "Surplus Cash" available in a particular year to meet the HUD or MSHDA requirements for a cash distribution. Hence, the owners of such developments cannot make withholding tax payments without being in default of their regulatory agreements with HUD or MSHDA.

Typically the mortgages for these affordable developments have 30, 35 or 40 year terms and have level monthly payments of principal and interest. As the properties and mortgages mature principal payments become an ever increasing portion of the mortgage payments. Although the interest portion of the mortgage payment is considered an expense for tax purposes the principal portion is not considered an expense. In addition most properties must also fund a replacement reserve held by MSHDA, HUD or the lender. These payments are not considered expenses for tax purposes either. The combined mortgage and reserve payments range between 40 and 65% of total rental income. As a result a property can have a "paper" profit but be just breaking-even or even losing money on a cash basis and therefore not be eligible for a cash distribution. Such "profits" in our industry are known as "phantom income".

The proposed amendment, which was developed in consultation with the Treasury Dept and the Michigan State Housing Development Authority, will resolve this conflict by providing that required withholding of taxes shall only be withheld from cash distributions approved and made in the tax year.